The Free Market
"If you don't create a free market, a black market will emerge"
NEWSLETTER OF THE LITHUANIAN FREE MARKET INSTITUTE - www.freema.org/Newsletter/index.phtml

NEWS

The latest study on the Lithuanian economy

In May LFMI released the latest study of the Lithuanian economy "A Survey of the Lithuanian Economy 2001-2002", based on a survey of economists' expectations. This Lithuanian-English study offers estimates of economic indicators for 2001 and forecasts for 2002, analysis thereof and comparison with official statistics and other sources. The study analyses GDP growth, the shadow economy, foreign trade, price changes, unemployment, the tax burden, earnings, household income, savings and investments, the profit margin, etc.

Market participants polled by LFMI see the Lithuanian economy growing and the financial situation of Lithuanian households and companies improving. They predict that these trends will remain through 2002. The Lithuanian economy will continue to grow at a similar rate as last year, by 4.4 percent. Rising domestic consumption, exports and investments will be the main factors of economic growth. However, the growth of Lithuania's exports and imports is likely to decelerate due to the world's economic slowdown.

This year prices are expected to rise faster than in 2001, by 3.3 percent; the official sources indicate a rise by 1.2 percent. The LFMI survey shows a sharp reduction in the tax burden in 2001, but the tax burden is expected to grow again and reach 38 percent of GDP this year. Although the informal economy has been steadily shrinking over the past years, market participants think that it will cease to contract and remain at the same level, 19 percent of GDP, in 2002 as a year before. The situation in the business sector will continue to improve, although not as fast as last year.

It is expected that Lithuania's improving macroeconomic situation, a stable financial sector and successful EU membership negotiations will boost foreign investors' confidence and injections in the Lithuanian economy.

LFMI analyses poverty issues

On May 30 2002 the Lithuanian Free Market Institute in co-operation with the United Nations Development Program held a conference "Explaining and Reducing Poverty in Lithuania: Prospects and Reality." The goal of the conference was to present poverty prevention policy in Lithuania, to discuss the causes of poverty and to propose ways and measures for reducing it. The event drew around eighty participants from the President's Office, the Ministry of Social Affairs and Labour, the Lithuanian Labour Exchange, Vilnius Municipality, UNDP, LFMI, various public organisations as well as business and media representatives.
In this issue of "The Free Market" we offer an excerpt from LFMI Vice President's presentation at the conference *(p. 4).*

LFMI presents its view on the future of Europe

On June 19 2002 the Lithuanian Free Market Institute, supported by European Commission Delegation in Lithuania PHARE Small Grants Programme, held a conference "Debate on the Future of Europe: a View from Lithuania." The goal of the conference was to widely present LFMI's position on major issues discussed at the European Convent as well as to stir up debates in Lithuania about the EU and Lithuania's accession. The conference was also designed to join the on-going discussion about the future of Europe that is aimed at finding ways how to make the EU a more democratic and effective organisation which would better meet its citizens' expectations. This conference was organised within the framework of LFMI's project on the future of EU the goal of which is to develop a comprehensive study. It will present principles of, and recommendations for, reforming the EU and its institutions, dividing competencies among the EU and member-states, and drawing citizens into decision-making process of the EU. The study will be completed by the end of July, translated into English and disseminated widely.

LFMI's President at a White House luncheon to honour M. Friedman

On May 9 2002 LFMI's President Ugnius Trumpa participated at a meeting "A Lifetime of Achievements: Milton Friedman at 90" held by the White House. To pay tribute to M. Friedman, U.S. President George Bush participated at the luncheon. As the "National Review" wrote, at the event President Bush spoke eloquently of Friedman's influential ideas and devotion to liberty and emphasized the power of the free market to uplift not only economies but national securities and education. Among the speakers were Secretary of State Donald Rumsfeld, Chairman of FRB Alan Greenspan, NEC Director Larry Lindsey, Attorney General Edwin Meese, and Dr. Gary Becker. The event drew around one hundred participants from U.S. political, economic and academic circles and other countries. Mr. Trumpa took part in this honourable event at the invitation of the Heritage Foundation.

FEATURE

Debates on pension reform started in Lithuania back in 1994. Today we have 2002, but the debates are still going on. In April 2001 the Government of Lithuania approved a draft law on pension reform, providing for the introduction of mandatory fully-funded pension insurance and giving people an opportunity to save for retirement through pension funds. Before that, major political parties in Lithuania reached a consensus on this issue. President Valdas Adamkus on many occasions urged decision makers to launch the reform without delay. The World Bank pledged to provide financial and technical assistance for the reform to be implemented. Unfortunately, the bill got stuck in parliament. Finally, after long considerations and heated debates the ruling Social-democratic coalition declined the bill. A decision was made to revise the bill and to start the reform by introducing voluntary rather than mandatory fully-funded pension insurance. Mandatory insurance, the argument was, would be too expensive for the country.

The Lithuanian Free Market Institute has participated in developing a legal basis for pension reform since the very beginning. The Institute crafted the first draft law on pension funds and helped to create a legal framework for supervision of pension funds and a plan for establishing a three-pillar pension system. An extensive media campaign has been conducted to explain the need and merits of pension reform. The article below, published in the Respublika *daily on 14 May 2002, refutes the Lithuanian Social Democrats' arguments against pension reform.*

Pension Reform. What Is to Be Reformed?

Guoda Steponaviciene, Vice President, LFMI

Pension reform has been discussed widely and thoroughly. Promises to start it have been many in number. It is small wonder that the object of, and the arguments for, reform have been somewhat forgotten. It is common knowledge that the current pay-as-you-go pension system is fraying because it is not viable financially. Social security contributions are large, while pension benefits are relatively small. This ratio is deteriorating due to Lithuania's adverse demographic trends. In addition to that, the current social security programme is based on redistribution, so there is a constant risk that political decisions to increase benefits will destroy the system's financial balance.

Being financially unworkable, the social security programme does not provide any incentives to participate in it and is being eschewed on a wide scale. This is not only aggravating the current predicament of the social security budget. It is demoralizing society as people are required to surrender their money to a scheme that does not bring expected returns.

Lithuania is not the only country to face this problem. Pay-as-you-go pension systems are a headache for all nations with the same heritage. Even Germany – the architect of a pay-as-you-go pension scheme – has after long debates decided to narrow it by establishing mandatory fully-funded insurance.

The social domain is not regulated at the EU level, but there are voices to pass legislation that would lay down fundamental principles of a pension system. Such proposals sound natural for several reasons. First, the European society is aging. Second, the financing of pay-as-you-go pension programmes is placing a heavy burden on European nations. Finally, the systems are a drag on European companies' competitiveness on global markets. The United States, for example, places a greater weight on private retirement savings plans (albeit not great enough in the opinion of the American society) and so is treading on Europe's heel in this area just as in others.

Let's do something to do nothing

One may conclude that Lithuania, being on the periphery of these worldwide developments, has not realized yet the magnitude of problems that the pension system is causing. Or, one may say, the difficulties that the reform will pose are understood much better than today's problems.

Naturally, every reform requires a great deal of resources – ideas, people and money – to change what has been normal, familiar and customary for many years. In every system, regardless of the degree of its usefulness to the society, there are people who are content with *status quo* and do not want any change.

The more complex and extensive a reform is, the more difficult it is to make a transition from the old to a new system. This is particularly true for the current pay-as-you-go pension programme. Both preserving the programme and dismantling it are impossible without losses. Any reform that is going to affect people directly causes a great deal of concern and therefore requires enormous efforts to explain to the society the need for, and the contents of, the changes to come.

Of course, the lot of reformers is not something to be jealous of. But it is the mission of politicians to create a legal environment or to change it so that people could create prosperity today, tomorrow and for many years to come.

Not so long ago all political parties in Lithuania expressed their support for pension reform. They said they would go along with a reform if the White Book explicitly described it as transferring a fraction of the current social security contributions to personal accounts in private pension funds. This was expected to strengthen the pension system, to reduce redistribution and to increase people's incentives to participate in the programme.

Today Lithuanian Social Democrats insist that the reform should start with introducing voluntary pension insurance. This proposition is tantamount to saying that people will be allowed not only to spend the money that is left after paying taxes and social security contributions but also to save for retirement!...

But this does not mean or require any reform! By proposing this, politicians are only giving a yet another instruction for people where they should spend their money. If that is the changes that are to be adopted, the real culprit of the current predicament and the need for reform – Social Security – would remain intact. It would continue to encumber the labour market, to jeopardise the country's finances and to cripple people's understanding about insurance.

The Lithuanian Free Market Institute has long called upon decision makers to entrust at least a fraction of the social sphere to the market in order to give some vitality for this fraying sector and some hope for Lithuania's future tax payers. Obviously, this reform is not going to be an easy one. It requires a sound model, a scrupulous action plan, an extensive public information campaign and political will and commitment. Today we are stuck right at the beginning – the proposed model is close to being rejected.

Coercion will not bring efficiency

The main problem with the proposed pension reform is that people will have to continue to participate in the current social security programme anyway. They will not be able to decide for themselves whether to pay social security contributions or, say, to keep gold in the cellar or deposits in banks or to buy real estate or simply to spend money today at the expense of their future income. It is claimed that people should be compelled to provide for retirement and that they should necessarily do it through social security. Thus the choice remains only within the pension system itself.

Today the system affords no choice whatsoever: everyone must pay social security contributions. Under the proposed reform model, part of the population (aged 30 to 50) would have an opportunity to direct a fraction of their social security contributions (five percent) to the new system (a pension fund of their own choice), while individuals over 50 years of age would have to remain in the old pay-as-you-go programme.

However, if the aim is to reduce people's liabilities as much as possible and to increase freedom of choice and individual responsibility for one's own future, it is necessary to allow all age groups to choose whether to stay in the current social security system or to pay the five percent of their social security contributions to fully-funded pension insurance. This would not increase the uncertainty surrounding the reform. Given that a large fraction of the population would have a right to choose under the proposed model, calculation of the costs of the reform would have to be based on forecasts regarding the number of participants in the new system anyway.

The Social Democrats use the notion of dividing the population into age groups in pointing out plans to introduce mandatory insurance. However, the proposed reform model does not mean mandatory insurance. The envisaged insurance, to be compulsory for people under 30 years of age, would be used within the boundaries of the current mandatory social security contributions. Under the scheme proposed by LFMI, pension insurance would not be obligatory to any age group. Those who wish to remain in the mandatory programme without fully-funded insurance would be able to do that, while others would be allowed to accrue part of their social security contributions in private pension funds.

A solution will dictate a means

Another factor increasing the uncertainty of the reform is that not s single pension fund has been established as yet in spite of the fact the Law on Pension Funds is in place. It is small wonder. Many more people wanted to participate in pension funds when the pension reform was started than today. Therefore the question as to what should come first – pension funds or a pension reform that would create a market for pension funds – is a chicken and egg situation. If the reform were implemented, it would provide a powerful incentive for pension funds to appear on the market. On the other hand, pension funds would diminish the uncertainty of the reform and facilitate the transition.

A pension reform is a lengthy process. The time gap between the adoption and the enforcement of pension reform legislation would leave enough time for the market to react to the news and for pension funds to spring up (provided lawmakers removed the existing unjustified restrictions on pension funds' investments). The risk that the time will be too short for pension funds to establish can be minimised as well. To do that, it is necessary to allow people to direct the five percent of their social security contributions not only to pension funds but also to fully-funded life insurance in insurance companies, a service that is already being used.

All roads lead to the treasury

A lack of money is invariably the final and deciding argument the Social Democrats use to cut off any discussion about the reform. This argument is used by anyone in power to confront proposals for long-term reforms. There is never free money in the state budget, just like in a private individual's pocket. For individuals, it is always easier and more pleasant to spend money on a new car or a holiday or any other tangible thing. This is understandable and justifiable because it is their own money that they spend. Administrators of taxpayers' money are also keen on spending it to achieve a fast and material effect, so they face a constant temptation to use the money for the benefit of individual groups rather than all citizens.

For example, they choose to grant special pensions for a few rather than raising pensions for all. They dole out various allowances, e.g., transport concessions, for selected groups rather than increasing benefits for all receivers. The desire to achieve fast results leads them to spend the money for today's beneficiaries rather than investing it so as to benefit other generations as well. Today the authorities are ready to find resources to establish a new state telecommunications operator or to subsidise housing loans but not for pension reform.

A research conducted by *The Economist* (February 16-22, 2002) shows that the damage that the replacement of the current pay-as-you-go pension programme and reform-related risks may do will be smaller than the harm that will be caused by doing nothing. Therefore the Social Democrats' position, albeit absolutely natural and even reasonable in the rhetoric of a political party, cannot be justified because it is injuring the Lithuanian people.

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FEATURE

"The Free Market" offers a few excerpts from a presentation by Guoda Steponaviciene delivered to a conference "Explaining and Reducing Poverty in Lithuania: Prospects and Reality" held by the Lithuanian Free Market Institute in co-operation with the United Nations Development Program on 30 May 2002.

The Causes of Poverty and Possibilities To Reduce It

By Guoda Steponaviciene, Vice President, LFMI

Equality or well-being?

In estimating the level of poverty in Lithuania, it is often emphasized that differentiation of wealth has markedly increased after the restoration of independence. This statement is used with a negative connotation. It is asserted that differentiation was not as big in the Soviet times and that growing inequality is now augmenting poverty.

First of all, one may ask whether it is correct to compare the present days with the Soviet era. After all, the differentiation between the privileged and ordinary people was especially big in the Soviet times. It did not always show through the wealth owned. The official statistics, in turn, did not reflect the amount of people's wealth. Yet, this is natural for a planned economy where status is a person's wealth. In a market economy, capital is wealth.

However, in terms of the quality and standard of life – the criteria by which poverty is estimated – inequality of opportunities was more than obvious. It is widely believed that ranking people by status in the Soviet Union and Lithuania was unintentional and accidental. Some think that it was not characteristic of socialism, a system that by definition was designed to achieve equality among men.

However, both theory and practice indicate that a planned economy cannot exist without inequality among citizens in terms of status because in the absence of private ownership and free prices there are no other criteria by which goods, which are always scarce, can be divided in society.

In a market economy inequality of wealth is inevitable because people, for objective and subjective reasons, take advantages of opportunities afforded by this order in different ways and to different extents. It is therefore incorrect to claim that differentiation has widened since the Soviet times. Inequality has always existed. What changed together with the transformation of the system is the criteria by which inequality is assessed, while the scope of inequality has widened because the new system has offered greater opportunities to create and obtain wealth.

It should also be taken into account that the general level of wealth was very low in the Soviet times. And it was isolation and ignorance of the opportunities that the capitalist world offered that made people consider themselves not to be poor. However, all of the pride of the people's state used to evaporate after the first visit to a Western store. Today people from North Korea flee the country, foregoing even privileged status in their homeland for any kind of job in a capitalist country.

Which of the two inequalities – social status or material well-being – does more harm depends on our value judgments. The doctrine of a market economy states that inequality in terms of freedom of action is unacceptable as such, while inequality of wealth is inevitable, no matter whether we like it or not.

It is no use from a practical point of view to discuss whether the existence of differences in people's abilities to gain wealth is good or bad, just like it is pointless to discuss whether it is good that, say, from the point of view of healthcare, people have different body composition or, from the point of view of education, people have different abilities to comprehend and study one or another discipline.

So in formulating policies of poverty prevention and social security, it is important to consider inequality as a circumstance determined by the wide variety of people as living beings and by differences in the environments in which they live. For this reason reducing inequality and reducing poverty are two different goals, the latter being of prime importance for all societies and all democratic governments.

The Causes of Poverty

When the iron wall separating us from the world collapsed, it did not take long for the world's standards of life to spread around. People perceived the benefits of goods and services produced around the world much faster than they learned how to create them. This sudden inconsistency between the wants and possibilities incited a great deal of tension. While some people saw it as a stimulus to work more and better, a stimulus to risk and to seek material well-being by all possible means, others did not want or manage to take advantage of it. They failed to put up with it and so found themselves in poverty, if poverty is understood subjectively.

Why don't some people want or manage to obtain a sufficient amount of money to satisfy their basic needs and not to feel poor?

This problem is particularly conspicuous in "welfare" states because the number of people who find government benefits sufficient to satisfy their needs grows together with an increase in the size of benefits. Benefits, in turn, go up as the standards of living rise (in addition to the right to life, ownership and freedom of expression, people begin to require other rights, such as the right to work, rest, internet and the like), while standards of living rise together with the growth of well-being.

Yet, at some point a limit is reached when wealth can no longer increase because those who live out of this wealth but do not contribute to it become too heavy a burden on society. A time for reform comes. For example, German analysts maintain that their "welfare" state cut the roots of its growth a long time ago and is now living from inertia. This means that a turning point on the growth curve has been missed and the process is descending, while the society continues to think that everything is and will be as always. Under such circumstances it is natural that proposals are being voiced to replace employment regulations, the pension system, the tax code and even the European Union. The problem is that not a single political party dares to admit it publicly. They know that people will be far from happy to learn that time has come to change. After all, avoiding change is human nature.

In Lithuania social benefits, except for benefits paid to large families, are not big. Yet, taking into account the average level of income, especially in small towns and rural areas, social assistance constitutes a valuable portion of people's income, especially as it is granted in cash rather than in kind. Social benefits thus give birth to a segment of society whose members choose not to seek jobs or take up some business activity but to live on social allowances. The state social security system is viewed as an employer who pays wages-benefits on certain conditions, such as having less income than x, possessing fewer square meters of dwelling than y, having more children than z, being registered in institution *alpha* but not registered in institution *beta* and so on and so forth. Meeting these requirements is what many people do for a living, as if being employed. Such incentives affect people's motivations and behaviour. Families and children – groups that the champions of social security are especially keen to support in words – are affected the most.

People in Lithuania have had merely a decade to learn to be responsible for their own lives and income. It is therefore difficult to single out the consequences of crippled motivations caused by social support, as all of the so-called mentality problems that spring up as a society makes a transition from socialism to capitalism are the outcomes of crippled motivations. Consequences of social support are particularly evident in capitalist "welfare" states that have deep-rooted traditions of social programmes. The Swedish society, for example, is concerned that the youth, being widely and generously supported by the state, comprehend rather late that the time has come to fend for themselves. In Sweden the provision of educational loans has already been restricted. The United States has long debated what effects the provision of allowances for single mothers has had on the status of family and children's possibilities to live with both parents.

Naturally, there will always be a group of people unwilling to make efforts in order to create material wealth. This circumstance has always existed but it never became a problem in the past because there were no anonymous interventions on the part of the state. They who chose to be poor voluntarily – both those able and unable to work – lived on private charity that was controlled by a concrete community, such as a local community, a voluntary association or a professional group. Since a life in community shapes people's motivations, this control was sufficient to prevent living on charity from becoming too attractive an occupation. In the twentieth century the state became an active player in social relationships and ousted private charity and control. It became difficult to distinguish between those unable and those unwilling to take care of themselves.

Many Western nations have already perceived the negative consequences that state aid has on people's life style and on children. They are contemplating different models and trying to figure out what fiscal measures could be used to encourage socially supported people to seek jobs without reducing social benefits. However, all such measures – tax breaks, concessions and allowances – have the same, only much more hidden, effects because receiving benefits will always pay more than paying taxes. The granting of social benefits that are sufficient to guarantee a fairly comfortable life threatens to undermine the foundations of well-being in democratic societies – the ethical norm that in normal conditions everyone has to pay for their well-being themselves, while any kind of government aid is an exemption from the rule.

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ACTIVITIES AND ACHIEVEMENTS

April – June 2002

Agricultural policy
At the request of the parliamentary Committee on Rural Affairs LFMI made an analysis of a draft law on agricultural and rural development. LFMI commented widely on agricultural policy in the media and public forums, highlighting the shortcomings of the allocation of a fixed portion of the national budget for agriculture as well as for other areas. On April 19 LFMI held a seminar "Will Agriculture Ever Be a Competitive Business?" to discuss whether agriculture should be treated as an exceptional branch of the economy and whether Lithuanian agriculture would become a competitive business domestically and in the European Union. The participants discussed the agricultural policy pursued by the Lithuanian Government, the outcomes of liberalisation of milk prices and other topical issues.

Capital market
LFMI continued discussion on the development of the securities market and the need to privatise the National Stock Exchange of Lithuania. On April 16 LFMI held a round table to discuss barriers to an effective operation of the capital market and policy initiatives to advance its growth. Capital market participants, experts, politicians and representatives of international institutions discussed why corporate governance traditions remain underdeveloped in Lithuania and what measures were needed to stimulate the securities market to better serve its function of facilitating effective capital distribution. The round table also analysed recent trends towards globalisation of securities markets and the prospects of privatising the National Stock Exchange of Lithuania. A resolution featuring the conclusions of the round table was issued to all participants of the event.

Company law
LFMI submitted to the Ministry of the Economy comments on and recommendations for a project of amendments to the law on joint stock companies. LFMI proposed abolishing a number of excessive restrictions envisaged in the law, such as a limitation on the number of shareholders in companies of limited liability, on types of creditors, interest rates and the distribution of profits on dividends and bonuses.

Financial Institutions. The parliamentary Committee on Budget and Finance approved a number of LFMI's proposals for a draft law on financial institutions, including proposals to bring the definition of leasing into line with the definition of financial institutions laid down in the Civil Code; to allow all financial institutions to provide financial services in foreign currency; to allow financial institutions to conduct activities other than financial sector activities provided that income generated from these activities does not exceed 10 percent of a company's total income; and to allow financial institutions to receive additional income from the management and use of assets in their ownership.

Deregulation

Building and Land Purchase. In April the Government of Lithuania approved a schedule for the revision of building and land purchase regulations and implementation of adopted policy measures under the so-called Sunrise programme. The said agenda incorporated a number of LFMI's proposals, such as: to define clear criteria that should be used to coordinate legitimate public interests in the process of preparing documents on territory planning; to improve the procedures for co-ordinating documents on territory planning with the public so that citizens could learn about the coordination of territory planning projects from the very beginning; to draft a new bill on territory planning and to clearly define conditions under which municipal authorities have a right to require a builder to expand the municipal infrastructure and to specify the rules of solving ownership problems; to improve the existing method of appraising state-owned land by establishing periodic (e.g., annual) revisions of land valuation ratios and a gradual transition to the application of the law on property and business valuation to state-owned land; and to simplify requirements applicable to the maintenance and utilisation of items of cultural heritage. All of the legislative amendments are scheduled for submission to the Government of Lithuania this year.

Customs. LFMI policy analysts continued to participate in the work of the Council for Customs Issues and the Sunrise task force on customs procedures and transit. In debating ways to simplify customs procedures, the Council adopted some of LFMI's recommendations. The Sunrise task force included in the policy schedule the following proposals from LFMI: to simplify procedures for bringing sample goods into the Republic of Lithuania, the procedures for granting credibility status for economic entities and regulation of customs warehouse. The schedule is to be shortly debated by the Government of Lithuania.

The Civil Code. As parliament initiated amendments to the Civil Code seeking to revoke the prohibition to make cash settlements, LFMI policy analysts urged policymakers to modify the said proposal and to allow all legal and natural persons to make both cash and non-cash settlements without limitation of the amount of settlements. The parliamentary Committee on Legal Affairs declined the proposal on the ground that "settlement relationships concern not only the parties involved." The amendment proposal was subsequently revoked.

Tobacco and Alcohol Control. On June 11 the parliament adopted amendments to the law on tobacco control revoking the requirement to renew every year tobacco production, import and wholesale trade licences. LFMI had urged the authorities to abolish the renewal of licences since 1998. In support of the president of Lithuania's veto of amendments to the law on alcohol control prohibiting outdoor alcohol advertising, LFMI issued an address to members of parliament stating that such prohibition would infringe on the freedom of information and choice and violate the interests of consumers and producers without giving any material results. LFMI called on the lawmakers to revise the proposed amendments and to discard the prohibition of outdoor alcohol advertising as a harmful and futile regulation.

Education

LFMI embarked on a project "Introducing a Voucher Funding System in Higher Education." The purpose of the project is to promote a financing reform in higher education based on voucher funding, to provide an independent expert input to the policy making process and to increase public understanding about the need for and contents of the proposed reform. LFMI also submitted to parliamentary committees a policy proposal calling for revision of the law on higher education which introduces a national fee for education services in public universities for all students (except the fifty percent, including the socially supported and the best students). Also, according to the law, state establishments of higher education will provide only government-funded educational service, while private establishments will be allowed to provide only educational services that are not financed by the state. This law was adopted in December 2001 and is to be enforced in September 2002. LFMI argued that this law discriminates against private higher schools and that its implementation will provoke sizeable budget expenditures; therefore, the law may be implemented improperly if it falls short of government funding. LFMI proposed establishing a task force to formulate amendments to the law that would create equal and transparent conditions for public and private establishments of higher education. Despite these recommendations, the functioning law will come into effect starting in the autumn of this year.

EU integration

LFMI continued to work on the project „Lithuania‘s Integration into the EU Single Market: Regulatory Impact on Lithuania's Economy“ and launched a research in the area of building regulations. LFMI will make an analysis of Lithuanian and EU legal acts regulating the activities in the building sector in various areas in order to evaluate changes in the Lithuanian legal environment and its implications for the building industry. LFMI policy analysts commented widely on the implications of EU Integration and the need for impact assessment analysis as well as on the most important policy events in the EU over the past three months and its implications for Lithuania in the national and regional media and during public events.

On June 19 LFMI held a conference "Debate on the Future of Europe: A View from Lithuania," supported by the PHARE Small Grants Programme of the European Commission Delegation in Lithuania. The aim of the conference was to present to policy makers and the society LFMI's position on the main issues currently debated in the European Convent and to provide a stimulus to public debates in Lithuania on the EU and Lithuania's membership in the EU. The conference audience included experts on EU affairs, politicians, representatives of the academia and media. A study prepared by LFMI on the aforesaid issues will be shortly released (in Lithuania and English).

Health care

On April 18 LFMI issued a press release to present its position on recently introduced quotas for compensated medicine. LFMI warned government authorities that the introduction of quotas would harm patients, slow down the restructuring of the healthcare system and aggravate working conditions of doctors, without helping to save health care funds. LFMI policy analysts proposed abolishing a government-approved list of compensated medicines and introducing a scheme under which patients would cover part of medicine prices. LFMI policy analysts also discussed this topic in the media.

Information technologies

LFMI policy analysts participated in the work of a Sunrise task force on informatics and telecommunications, helping to draw a list of barriers to the information technology and telecommunications markets. LFMI provided an input to the development of and debates on a project of amendments to the law on electronic signature. The bill, aimed at expanding the possibilities of using e-signature on the market, was adopted in parliament on June 6. LFMI is also contributing to the preparation of a conceptual framework for e-government. A package of comments and proposals was submitted to a task force working on the framework.

Labour market policy

LFMI policy analysts took an active part in parliamentary debates on a new labour code. In order to express concern about the drawbacks of the new labour code, LFMI together with nine other organisations addressed the president of Lithuania and members of parliament. In a joint letter of notification they emphasised inappropriate provisions of the new labour code and their implications for the country's economy and society. They called on members of parliament to decline the bill and urged the president to veto it in case it were adopted. On May 21 LFMI held a press conference "The New Labour Code – a Catalyst for Unemployment" to highlight the main flaws of the bill and the likely consequences for the development of the labour market and economic growth. LFMI widely commented on these issues in the press and on radio and television. Despite this intensive policy advocacy campaign many weaknesses remained and the new labour code was adopted.

NGO legislation

LFMI made an analysis of a draft law on public organisations, submitted to the parliament by the Government, and formulated comments and proposals for the legal regulation of the activities of public organisations. The main proposals were to allow public organisations to establish non-collegial governing bodies, to revoke the requirement for public organisations to conclude employment contracts with heads thereof and to abolish the prohibition for public organisations to guarantee the fulfilment of third parties' liabilities. LFMI presented its conclusions and recommendations to parliamentary committees and took an active part in parliamentary debates. In response to proposals to prohibit public organisations from conducting commercial activities, LFMI presented arguments against them. LFMI noted that a six-year experience of public organisations' commercial activities did not show any negative consequences.

Privatisation and competition

LFMI continued to promote privatisation of the National Stock Exchange of Lithuania. LFMI made an analysis of a draft law on enterprises and plants of strategic significance for national security and called on parliamentary committees to decline it. LFMI argued that the draft law envisaged inappropriate measures to ensure security and a proper functioning of items having strategic importance for national security and failed to specify criteria by which such items were selected. LFMI analysed a draft law on heating and submitted comments and conclusions to the parliament. According to LFMI, the law would restrict the heating production and supply market. It would preserve the current uncompetitive and ineffective system, depriving consumers of the possibility to receive services that would meet their needs and financial capacities. LFMI called on decision makers to abolish heating price regulation and to abandon plans to divide municipal territory by means of heating. It was concluded that legal conditions had to be created for residents to choose and change means of heating at their own discretion, provided they complied with established environment protection and other requirements. The draft law submitted to the parliament restricted such possibilities. LFMI policy analysts presented the institute's position on the draft law and likely pitfalls of the proposed regulations in a series of radio appearances.

Public administration

Public Procurement. The parliamentary Economic Committee adopted the following LFMI recommendations for a project of amendments to the law on public procurement: (i) the purchasing organisation may require from the supplier only information that is necessary to determine whether the supplier meets the financial, economic and technical requirements posed by the purchasing organisation; (ii) purchases that are related to secret information of the state as established by law are not subject to the provisions of the law the application of which would not guarantee the safekeeping of the secret information.

Legislature. LFMI policy analysts continue to participate in the Legislative Commission under the Ministry of Justice. They are heading a task force developing a model of the legislative process and proposals for the evaluation of the existing legislative process.

Social policy

On May 30 LFMI in co-operation with the United Nations Development Program in Lithuania held a conference „Explaining and Reducing Poverty in Lithuania: Prospects and Reality." The purpose of the conference was to bring together social policy experts, politicians, municipal officials and business people to discuss the causes of poverty in Lithuania and ways to reduce it. The audience of the conference comprised 80 participants representing the President's Office, the Ministry of Social Welfare and Labour, the Lithuanian Labour Exchange, the United Nations Development Program, various non-governmental organisations and mass media.

Housing. On June 4 LFMI President Ugnius Trumpa attended a regional symposium „The Economic Impact of Registered Pledge Systems in Five Transition Economies“ in Gdansk, Poland, organised by the East-West Management Institute, in co-operation with the Gdansk Institute for Market Economics. Representatives from Poland, Lithuania, Bulgaria, Albania, and

Hungary spoke about their countries' experience in developing registered pledge systems and drew lessons for the future. Ugnius Trumpa delivered a presentation about the property pledge reform in Lithuania and its effects for enterprise development and economic growth. This presentation was based on a study developed as a result of a project "Evaluating Economic Implications of Property Pledge Reform in Lithuania," carried out by LFMI in co-operation with the East-West Management Institute.

The housing problem is an important issue for many people in Lithuania. In order to improve the housing environment and facilitate the acquisition of dwelling facilities, government authorities are drafting new legal acts on housing policy. One of them is a draft law on housing savings and crediting. This document is "to create a legal basis for a government-supported system of housing saving and crediting." The draft law was prepared in accordance with the principles of Bausparkassen systems, as established in some foreign countries. LFMI analysed the draft law and developed an analytical study describing the principles of the Bausparkassen model proposed in Lithuania and giving an overview of overseas experience. The analysis of the draft law and the study were disseminated among government authorities, financial institutions, other business organisations and specialists. The study also presented a cost analysis of introducing a Bausparkassen system for society, likely benefits for individual interest groups, possible pitfalls and implications for the country's financial sector and the housing market. The analysis of the principles of Bausparkassen systems and the practical application thereof in Central and Eastern Europe showed that the systems failed to achieve the goals they were designed to serve. It entailed excessive costs for society and produced a negative impact on market processes.

Pension Reform. In response to the position of the parliamentary Committee on Social Affairs and Labour regarding pension reform, on April 25 LFMI issued a press release urging the policy makers not to postpone the reform of the pension system. LFMI noted that a lack of political will and further delays would discredit social security reform and threaten to undermine the stability of state finances. LFMI policy analysts commented widely in the press and on radio and television on this issue. Despite a great deal of criticism the draft law on pension reform was not approved.

Tax policy

LFMI policy analysts continued to analyse tax legislation and participate in the Sunrise task force on taxation. The work focused on the corporate and personal income taxes, value added tax and excise duties. The Ministry of Finance adopted a number of proposals submitted by the task force for new drafts and secondary legislation. In a press conference on April 30 LFMI announced May 4 the Tax Freedom Day. In 2002 an average Lithuanian tax payer had to work 123 days to pay the total bill imposed by all levels of government to pay salaries to public officials and to maintain such public sectors as national defence and the public healthcare, social security and educational systems.

Personal Income Tax. On April 3 LFMI policy analysts held a discussion "Progressive and Proportional Income Taxes: Social and Fiscal Functions" at the parliament of Lithuania. The aim was to bring home to law makers the shortcomings of progressive income taxation and the advantages of a proportional system before a decision was made to replace the existing tax code.

LFMI analysed a draft law on the personal income tax and submitted a package of comprehensive comments and proposals to parliamentary committees and fractions. LFMI stated that the proposed draft law was extremely complicated and so it would be hardly possible to properly implement the provisions of the law. The law would not only impose a heavy tax burden on the people of Lithuania. It entails a heavy indirect burden of administering the tax. LFMI urged the policy makers to improve the draft law by simplifying as much as possible the envisaged tax rules. Another proposal was to cut down the upper personal tax rate from 33 to 29 percent and to charge a 15-percent tax rate on as many as possible types of income. As debates on the draft law continued, LFMI carried out an extensive public dissemination campaign. The parliament adopted and incorporated in the draft law the following proposals from LFMI: to spell out the definition of the property of sole proprietors, to allow the inclusion of property reconstruction expenses of all family members in sole proprietors' expenses on the acquisition of property, to simplify the rules of classifying income by categories, to replace monthly A-class income tax declarations with quarterly declarations, to revoke the requirement that residents submit a written request to issue notifications about their received income.

Tax Administration. LFMI criticised the initiative of the Ministry of Finance to expand the powers of tax officers and to allow them to judge at their own discretion the substance of tax transactions and to conclude whether they entailed any abuse of tax rules. LFMI submitted a policy paper on the proposed amendments to the law on tax administration to the Government of Lithuania and the parliament. As a result, the provisions of the law were softened but the amendments were adopted. The business community expressed serious concern about the likely consequences of the law. In the media and in a series of radio and television appearances, LFMI policy analysts commented on the new provisions of the law on tax administration and explained their implications. LFMI called on the law makers to delegate the right to explain tax legislation to the Ministry of Finance instead of the State Tax Inspectorate.

After eight years of debates legislative amendments were adopted in order to provide for the merger of the tax collection and information systems of the State Tax Inspectorate and the State Social Insurance Fund. LFMI had submitted this proposal to all preceding administrations.

Turnover Tax. The Ministry of Finance submitted to the Government of Lithuania a draft law on turnover tax, providing for the introduction of a turnover tax instead of excise duties on certain groups of commodities (as of July 1, 2002 excise duties are charged only on tobacco, alcohol and fuel. Other types of commodities, previously subject to excise duties, were exempted in accordance with the EU law). LFMI called on the Government and the parliament to decline the bill. Despite that, the law was adopted. A new - turnover – tax was imposed on passenger cars worth more than 100,000 litas, publications of erotic or violent nature and perfume, cosmetic and other articles containing ethyl alcohol as listed by the Government of Lithuania. LFMI's criticism spurred debates on the appropriateness of taxing passenger cars but this provision remained in the law.

State Dues and Levies. At the request of the Constitutional Court LFMI submitted its opinion on the compatibility of certain provisions of the law on state dues and levies with the Constitution of the Republic of Lithuania. LFMI concluded that the law on state dues and levies, which came into force in 2001 and lowered state dues for licenses, provided that licenses that had been obtained and paid for in accordance with the preceding law would remain in effect after the coming into force of the new law. The new law failed to provide for the repayment of the difference in state dues and so created unequal competition conditions for economic entities who paid the dues for the same calendar period according to different laws and at different rates.

Telecommunications

LFMI analysed a project of amendments to the law on telecommunications and formulated recommendations for improving the draft. In a policy paper LFMI noted that the draft envisaged excessive regulatory instruments and threatened to undermine the legal basis governing the telecommunications market. As the analysis showed, an outdated sector regulation approach was applied to the telecommunication market instead of the principles of competition law. This would allow the regulatory institution to protect state service providers. LFMI called on the Government to decline the draft and to work out a telecommunications law aimed at creating conditions for free competition in the telecommunications market. According to LFMI, the law should be based to the new package of EU directives on telecommunications and reflect the principle of minimum government interference in the market. When the draft was submitted to the parliament, LFMI policy analysts provided a series of testimonies before parliamentary committees and presented LFMI proposals designed to reduce the regulatory burden imposed on market participants and to establish clear and limited powers of the regulatory institutions. A number of LFMI's recommendations found expression in the bill.

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If you don't create a free market, a black market will emerge

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LFMI pursues its mission by conducting research on key economic policy issues, developing conceptual reform packages, submitting policy recommendations at the legislative and executive levels, drafting and evaluating legislation, and launching public campaigns. LFMI's activities also include sociological surveys, publications, conferences, workshops, and lectures.

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